

EU Taxonomy on sustainable economic activities – preliminary assessment of the implications for corporate energy efficiency investments

Bettina Dorendorf
KfW Bankengruppe
Charlottenstrasse 33/33a
D-10117 Berlin
Germany
Bettina.Dorendorf@kfw.de

Keywords

energy efficiency investments, business models, EU taxonomy, sustainable finance

Abstract

Transforming the economy to achieve the goals of the Paris Agreement and for this purpose pursuing a carbon neutral economy in 2050 requires an additional yearly investment volume in the range of EUR 175 to 290 bn per year according to estimations of UNEP FI.¹

The EU Action Plan on Financing Sustainable Growth, adopted in March 2018, pursues inter alia the increase of direct capital flows towards sustainable investments, of which corporate and industrial energy efficiency investments are a part of.

However, so far there is no clear and widely accepted definition what the term “sustainable” means in this context. An important step in this direction is a new regulation which establishes a framework to facilitate sustainable investments. The Taxonomy Regulation, part of the EU Action Plan, forms the basis for a classification system by determining clear criteria under which an economic activity can be considered “green” in the sense of ecologically sustainable (referred to as “taxonomy” or “EU taxonomy”).²

For this purpose, the EU taxonomy defines specific quantitative and qualitative criteria (metrics, thresholds and do no significant harm-criteria). Their application will be binding for those providers of investment products which claim their products are sustainable (creating transparency) as well as for large corporates in respect to their non-financial reporting.

A Technical Expert Group (TEG), created to assist the EU Commission in defining the technical criteria for the taxonomy, has distinguished 70 economic activities and has defined for each of them the specific conditions which have to be met in order to consider an economic activity ecologically sustainable.

This peer reviewed paper will describe the main elements of the EU taxonomy for sustainable economic activities and make a preliminary assessment of the impact on corporate energy efficiency investments based on the example of the renovation of a production facility (non-residential building). It will point out the need for action for the corporate sector and discuss the main challenges for corporate energy efficiency investments to comply with the taxonomy requirements.

Disclaimer: at time of writing, the EU Taxonomy Regulation has not yet been fully adopted (expected 1st half 2020). Also, the Delegated Act with the final version of the technical screening criteria has not yet been published (expected for end of 2020). However, fundamental changes with regard to methodological approach and scope are not expected.

1. United Nations Environment Program Finance Initiative.

2. In this paper, the term “taxonomy” or “EU taxonomy” relates to the Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment, and amending Regulation 2019/2088 on sustainability-related disclosures in the financial services sector (2018/0178(COD)), as adopted by the European Council on 15.4.2020.

Introduction – setting the scene

Under the Paris Agreement³, 195 countries have committed to carbon neutrality by the second half of the 21st century. Pursuing this goal goes along with a transformation of all economic sectors. The cost of this transformation is huge and the additional investments required are estimated in a range between EUR 175 and 290 bn per year is required according to estimations of UNEP FI.

In this context, the EU Action Plan on Financing Sustainable Growth, adopted in March 2018, pursues inter alia a substantial increase of direct capital flows towards sustainable investments, of which corporate and industrial energy efficiency investments are a part of.

But what is to be understood by “ecologically sustainable”? So far, there is no market wide accepted definition based on an objective and measurable catalogue of criteria. The development of the EU Taxonomy on sustainable economic activities, formalised by the Taxonomy Regulation, is an important step in this direction. It introduces clear guidance what it means for economic activities in different sectors to be sustainable in the sense of being compliant with the objective of carbon neutrality, with quantitative and qualitative criteria based on scientific evidence.

It is one of the key tools of the European Commission’s green political agenda and plays a prominent role in the communication of the European Green Deal, “as a measure for strengthening the foundations for sustainable investments”⁴. The newly proposed Green Bond Standard⁵, which at present is voluntary, requires full application of the taxonomy criteria on a project by project level.

Many aspects of the practical implementation of the taxonomy criteria as well as case studies reflecting market reaction on the applicability are still under development.

However, there is no doubt that the EU Taxonomy will become an important and influential reference for the corporate sector.

Corporate energy efficiency investors will be confronted with new data and information requirements and should start preparing themselves for this challenge.

Background EU Taxonomy – political context and objective of the paper

POLITICAL CONTEXT

The starting point for the development of the EU Taxonomy for ecologically sustainable economic activities was the EU Action Plan on Financing Sustainable Growth dated March⁶ 2018 pursuing the following three main objectives:

1. **Reorientation of capital flows towards sustainable investment** in order to achieve sustainable and inclusive growth;
2. **Management of financial risks stemming from climate change**, resource depletion, environmental degradation and social issues; and
3. **Fostering of transparency and long-termism** in financial and economic activity.⁷

Basically, the EU Taxonomy consists of two main elements, which are central for this paper⁸:

1. The Taxonomy Regulation, setting the framework, directly applicable by all European Member States and expected to enter force in the second half 2020
2. The technical screening criteria, developed by a Technical Expert Group (TEG) and to be adopted by the European Commission via a series of Delegated Acts. The first is scheduled for End 2020 with mandatory application starting in 2022 (in relation to financial year 2021). A subsequent Delegated Act is scheduled for end of 2021 for application by end of 2022.

OBJECTIVE OF THE PAPER

The primary objective of this paper is to provide an introduction to the main features of the EU Taxonomy on sustainable economic activities.

It will give an overview on the new transparency and reporting requirements resulting from the Taxonomy Regulation and describe the consequences and challenges for corporates investing into energy efficiency resulting from the new transparency and reporting requirements of the EU Commission.

Additionally, it will discuss the main practical issues to be resolved based on the example of a corporate energy efficiency measure, the renovation of a production facility (non-residential building). The practical challenges (to the extent clear known at the time of writing) for corporates to comply with the requirements for the objective Climate Change Mitigation complete this section.

Finally, it will briefly outline, how KfW, the German promotional bank, has taken the lead in preparing the German corporate sector for the upcoming Taxonomy with a new promotional product.

7. The EU action plan provides for 3 legislative initiatives: A – Taxonomy Regulation; B – Disclosure Regulation; C – Benchmark Regulation.

8. **Taxonomy Regulation:** The legal framework of the EU taxonomy is set by the Taxonomy Regulation which is directly applicable by all European Member States. The European Council of Ministers has adopted the Regulation by 15 April 2020, while adoption by the European Parliament is still outstanding the time of writing. The Taxonomy Regulation is expected to enter into force in the second Quarter 2020. **Technical screening criteria:** The European Commission will approve the technical criteria developed for the first two environmental objectives (climate change mitigation and adaptation) as deemed appropriate (after conducting an impact assessment and further consultations) and they will enter into force through a Delegated Act to be adopted by the EC end 2020 with application by 31.12.2021. Mandatory application starts with regard to financial year 2021. For the remaining 4 environmental objectives, associated economic activities will be defined and relevant performance criteria will be developed following the same logic (see above). It is foreseen that they will be adopted via further European Commission Delegated Acts in 2021 for application by 31.12.2022 (relevant for the financial year 2022). The result of this process will be a complex universe of technical screening criteria, which will also not be final, but which will be changed, adapted and expanded over time.

3. Agreement within the United Nations Framework Convention on Climate Change (UNFCCC), dealing with greenhouse-gas-emissions mitigation, adaptation, and finance, signed in 1992. The agreement’s language was negotiated by representatives of 196 state parties at the 21st Conference of the Parties of the UNFCCC in Le Bourget, near Paris, France, and adopted by consensus on 12 December 1992.

4. The European Green Deal (COM(2019) 640 final). 11.12.2019.

5. Technical Expert Group on Sustainable Finance. Proposal for an EU Green Bond Standard. March 2020.

6. Action Plan: Financing Sustainable Growth (COM(2018) 97 final). 8.3.2018.

1. Climate change mitigation	2. Climate change adaptation
3. Sustainable use of water and marine resources	4. Transition to a circular economy, waste prevention and recycling
5. Pollution prevention and control	6. Protection of healthy ecosystems

Source: Dorendorf 2020

Figure 1. The six environmental objectives outlined in the taxonomy regulation.

The EU Taxonomy: overall objective, nature and level of ambition

The main overarching objective of the EU Taxonomy⁹ is to steer capital flows towards ecologically sustainable investments.

It creates a common language and reference system and helps market actors to understand what is meant by the term “sustainable”. The EU Taxonomy creates a scheme which makes it possible to assess the degree of sustainability of an investment. More precisely, it provides the first classification system ever determining under which quantitative and qualitative conditions economic activities that are the subject of financing or investment can be considered sustainable (or “green”).

With such a clear guidance and orientation, investors have an objectivised basis to compare the “real” degree sustainability of investment products labelled as such.

This is assured by the EU Taxonomy Regulation which introduces new and strict transparency and reporting requirements for investment products. Whenever investments are (packaged and/or (re-) financed by regulated financial products such as a fund or a bond marketed as sustainable, they have to comply with the new transparency requirements.

But the EU taxonomy does not create a new label for financial or investment products. Nor it restricts investments in those economic activities not in line with the taxonomy criteria.

In future, the EU Commission aims to embed the EU Taxonomy in further EU laws and thus create the basis for its application in various areas (e.g. setting standards, determining measurement procedures).

This underpins the cross-cutting character and long-term relevance of this new classification system.

GOVERNANCE OF THE EU TAXONOMY

The EU Taxonomy is a long-term project and the EU Commission will be the main responsible party for its development.

The initial technical screening criteria have been developed by the so called “Technical Expert Group” (TEG) mandated by the EU Commission until September 2020. To assure long term governance, a Platform on Sustainable Finance¹⁰ will be set up by the EU Commission as successor to the TEG by Autumn 2020. Its members will develop further criteria and address practical questions in relation to the practical application. Their tasks are outlined in the Taxonomy Regulation.

Members of the platform will be a broad range of experts as well as representatives of the European Environment Agency, the European Supervisory Authorities, the European Invest-

ment Bank and the European Investment Fund as well as the European Union Agency for Fundamental Rights.

IMPACT ON THE CORPORATE SECTOR

With the EU taxonomy, not only long term and complex transparency and data requirements are introduced to the European corporate sector. It also provides an orientation for corporates as to what it would require for their activities to become carbon neutral.

More specifically, from the point of view of a company investing into energy efficiency (as an example), the relevance and potential requirements to provide data and information will depend on the source of finance as well as on the size and reporting requirement of the corporate itself.¹¹

- In case the **investment is financed for instance by a fund or bond marketed as sustainable**, full transparency must be given by the financial product provider as to how and to which extent the taxonomy criteria have been applied and complied with. This can only be achieved with corresponding information from the investee company.
- In case the **company itself or the financial institution/entity providing finance** for the energy efficiency investment is subject to **non-financial reporting requirements**, transparency as to the degree of application and compliance with the taxonomy criteria must be provided.¹²

Against this background, the corporate sector will need to develop knowledge of and prepare for the new data and information requirements.

Structure of the taxonomy

SIX ENVIRONMENTAL OBJECTIVES¹³

The proposed EU taxonomy focuses on 6 environmental objectives, outlined in the Taxonomy Regulation (see Figure 1).

CONDITIONS FOR SUSTAINABILITY

For an economic activity (such as building renovation) to be considered environmentally sustainable, several cumulative conditions must be met.¹⁴

9. Taxonomy Regulation, Recital (3).

10. Taxonomy Regulation, Article 15.

11. For instance, large companies with on average 500 employees are subject to the Non-Financial Reporting Directive (NFRD), according to which corporates have to disclose how and to which extent they have applied the taxonomy criteria.

12. Taxonomy Regulation, Article 4delta.

13. Taxonomy Regulation, Article 15.

14. Taxonomy Regulation, Article 3, setting out the criteria for ecologically sustainable activities.

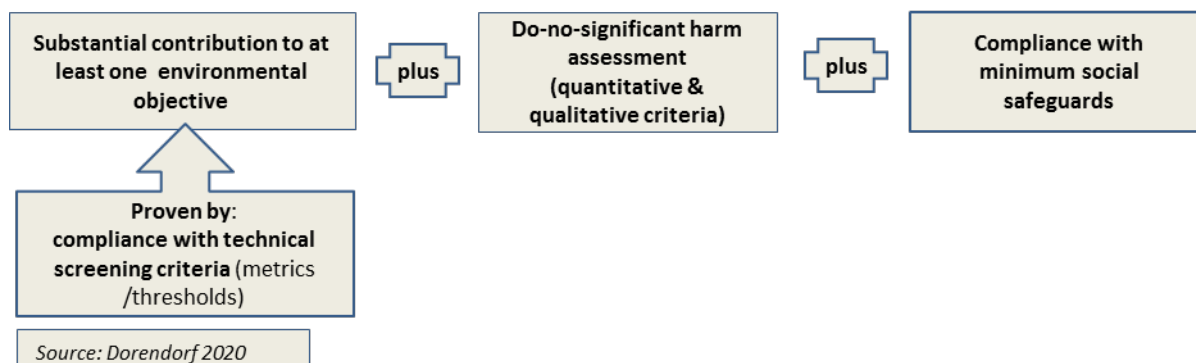


Figure 2. The conditions for sustainability.

1. Substantial contribution to one or more of the six environmental objectives named above (as a proof, compliance with principles and specific technical screening criteria (metric/threshold) must be given).
2. No damage to the other taxonomic objectives is caused by the exercise of the economic activity (proof provided with the so called Do No Significant Harm-Assessment).
3. Compliance with predefined minimum social safeguards.

THE TECHNICAL SCREENING CRITERIA – BACKBONE OF THE EU TAXONOMY

The technical screening criteria, developed by the TEG, are the backbone for the implementation of the EU Taxonomy.

They are ambitious, designed to pursue carbon neutrality in 2050 in line with the objectives of the Paris Agreement. They are based on scientific evidence and help understanding how the transformation of economic sectors towards carbon neutrality can look in practice.

Their purpose is to define for each of the six environmental objectives and the economic activities, under which conditions a substantial contribution to an environmental objective is achieved - in other words what is required to be considered ecologically sustainable or “green”.

The technical screening criteria are developed in several steps:

Step 1: the first set of criteria focuses on the two environmental objectives Climate Change Mitigation and Climate Change Adaptation. It has been developed by the Technical Expert Group and delivered to the European Commission in March 2020.¹⁵

- For this purpose, 70 economic activities have been identified to determine the criteria for a significant contribution to Climate Change Mitigation. They are based on the EU NACE codes¹⁶. The rationale for starting with this particular environmental objective was that the sectors covered by this selection represent 93 % of GHG emissions.

- For the objective Climate Change Adaptation, 68 economic activities have been identified.

Step 2: the second set of criteria will be developed by a Sustainable Finance Platform, successor to the TEG, supposed to start work in autumn 2020, and its focus lies on the remaining four objectives.

For each of these objectives, the relevant economic activities will be identified and the technical screening criteria will be defined.

SOCIAL SAFEGUARDS

In addition to the technical criteria, the taxonomy criteria suggested by the TEG define comprehensive social safeguards, which have to be complied for an economic activity to be eligible under the taxonomy.¹⁷

Sectoral coverage

The technical screening criteria have been developed for seven sectors; these are: (1) agriculture and forestry, (2) manufacturing, (3) electricity, gas, steam and air conditioning supply, (4) water, sewage, waste and remediation, (5) transport, (6) information and communication technologies and finally (7) buildings.

Within these sectors, economic activities are categorised into three different groups (see Figure 3).

Obligations resulting from the Taxonomy Regulation

The Taxonomy Regulation requires that providers of financial products that are regulated and labelled/ marketed as “green” or sustainable have to indicate, whether or to what extent the technical screening criteria of the taxonomy have been applied, and thus provide orientation and security for sustainability-oriented investors.

The criteria are not only binding for financial products labelled as sustainable in the sense of having to provide transparency after the taxonomy enters into force, they will also become a mandatory basis and reference point for future legal provisions of the EU or its Member States in relation to financial

15. EU Technical Expert Group on Sustainable Finance: “Taxonomy report: Technical Annex. Updated Methodology & Updated Technical Screening Criteria”. March 2020.

16. “Nomenclature statistique des activités économiques dans la Communauté européenne” (NACE) is a European industry standard classification system.

17. Alignment is required with: The OECD Guidelines for Multinational Enterprises and the UN Principles on Business and Human Rights, including the International Labour Organisation’s (ILO) declaration on Fundamental Rights and Principles at Work, the eight ILO core conventions and the International Bill of Human Rights. Where stricter EU- rules exist, these apply.

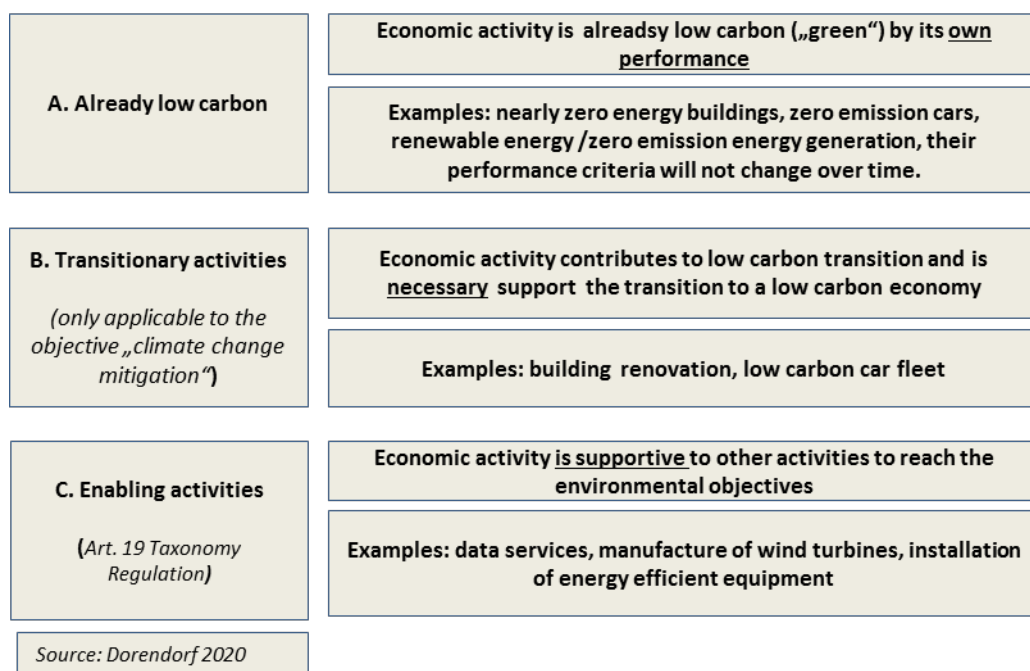


Figure 3. The three groups of economic activities.

products as well as corporate bonds labelled and marketed as sustainable.¹⁸

This underpins that the taxonomy has a cross-cutting character.

The transparency obligations created by the Taxonomy Regulation for financial market participants and financial products are formally introduced by amending the Disclosure Regulation¹⁹. And it will be relevant for large corporates (on average more than 500 employees – including financial institutions and insurance companies) – obliged to report on non-financial subjects according to the Non-Financial Reporting Directive.²⁰

This is important to keep in mind, because these legal provisions trigger the specific need for data and information to be provided by the corporate sector.

The transparency requirements for the disclosure of information by financial market participants and large corporates relate to the specific economic activity/projects carried out by a company (and not to the overall business activities of a company).

As a consequence, in case an investment product claims to include or be based on ecologically sustainable investments, there is the requirement to analyse the projects or companies financed by a given financial product and determine the degree of compliance of the project or the company's activities with the EU Taxonomy criteria, expressed as a percentage of turnover and/or CAPEX/OPEX.

18. See Taxonomy Regulation, Article 4; example: Disclosure Regulation.

19. Regulation on Sustainability Related Disclosures (EU2019/2088).

20. Non-Financial Reporting Directive (2014/95/EU). This directive amends the accounting directive 2013/95/EU, according to which companies are required to include non-financial statements into their annual reports from 2018 onwards. In June 2017, the EU KOM published guidelines to companies in this regard; in December 2019, the EU Green Deal was published, according to which the EU KOM plans to review the Non-Financial Reporting Directive in 2020.

In other words, a high degree of transparency must be produced: even if a financial product does not claim to be fully sustainable or does not pursue sustainable objectives at all, a corresponding disclaimer has to be issued stating this.

An important example for the EU Taxonomy serving as a reference is the newly developed proposal for a Green Bond Standard²¹ which has been also been developed by the Technical Expert Group. According to this new standard, the technical screening criteria have to be applied in full to qualify as underlying assets for a green bond issued under the new standard.

CONCLUSION

A broad spectrum of market participants – including the corporate sector investing into energy efficiency – will be required to produce relevant data and documentation and create transparency as to the degree of compliance with the taxonomy criteria and for this purpose apply the metrics/thresholds and do “do no significant harm” assessment.

Implication for energy efficiency investment – Practical example based on the environmental objective Climate Change Mitigation

At time of writing, the final technical criteria of the EU Taxonomy have not yet been decided by the EU Commission (corresponding European Commission Delegated Act scheduled for December 2020).

Also, there is still a lack of practical case studies regarding the application of the taxonomy technical criteria on real projects. Many procedural aspects are still under development.

21. Technical Expert Group on Sustainable Finance. TEG Report. Proposal for an EU Green Bond Standard. March 2020.

Table 1. EU Taxonomy criteria to a non-residential building renovation based on the objective Climate Change Mitigation.

Metrics and Thresholds Choice between:	Building Renovation Requirements proving substantial contribution to Climate change mitigation	Remarks
(a) Compliance with existing buildings regulation	Major renovations: comply with the requirements set national regulations transposing the Energy Performance of Buildings Directive (EPBD). The energy performance of buildings or the up-graded part must meet cost-optimal minimum performance requirements in accordance with the EPBD.	No changes to existing requirements for comprehensive refurbishments.
(b) Relative improvement of Primary Energy Demand	Building renovation: at least 30 % reduction of Primary Energy Demand in comparison with the energy performance before renovation. This relates not of the entire building, but to the specific renovation measure. The initial energy performance and estimated improvement shall be based on an energy performance certificate, an energy audit conducted by an accredited expert or another transparent method.	The option of a relative reduction of PED provides flexibility to investors, as the measures can be concluded within three years.

Against this background the following section seeks to create awareness for companies investing into energy efficiency on the scope and nature of information and data to be potentially made available in the near future.

RENOVATION OF PRODUCTION FACILITIES (NON-RESIDENTIAL BUILDINGS)

The following discusses the practical application of the EU Taxonomy criteria to a non-residential building renovation based on the objective Climate Change Mitigation. It delivers a preliminary assessment of the implications for corporate energy efficiency investors.

Building renovation is considered to make a substantial contribution to Climate Change Mitigation by reducing energy consumption and GHG-emissions.²² It is classified as a transitional activity.

The buildings related section of the technical screening criteria (Chapter 8 of the Technical Annex to the Taxonomy Report²³) does not distinguish between residential and non-residential buildings and lists four buildings related activities:

8.1 Construction of New Buildings, 8.2 Building renovation, 8.3 Individual measures and professional services and 8.4 Acquisition and ownership.

Building renovation is regarded ecologically sustainable when it complies with the conditions in Table 1^{24, 25, 26}.

DO NO SIGNIFICANT HARM ASSESSMENT ("DNSH-ASSESSMENT")

The DNSH-assessment is based on the analysis of the potential harm which might be caused by the economic activity in relation to the other 5 environmental objectives. We will discuss here a selection of important points of the required DNSH assessment for building renovation from the perspective of a practical implementation.

For Building renovation, the DNSH-assessment comprises the elements shown in Table 2²⁷. (In relation to objective 1, no DNSH-assessment is required, because the criteria for substantial contribution relate to objective 1.)

SUMMARY ASSESSMENT WITH REGARD TO THE DNSH-ASSESSMENT

- The DNSH-assessment in our view constitutes the main challenge for users of the EU-Taxonomy.
- It adds a high degree of complexity to the classification system and triggers additional costs for those parties having to deliver information and data to document the degree of compliance with the criteria.
- At time of writing, the majority of the aspects of practical implementation have not yet been discussed nor resolved.
- The foregoing example shows the high number of operational details to be sorted out by market participant – corporates as well as parties mandated to conduct due diligence.

Corporates: need for timely action

Given that the first financial year of application of the broad range of transparency and reporting requirements criteria is 2021, the time for preparation of market participants – being financial product providers or corporates can be considered short.

The processes for defining regulatory technical standards relevant for format and content of reporting by financial product providers in line with the taxonomy regulation are still under preparation.

FOR CORPORATES, THIS GOES ALONG WITH THE FOLLOWING NEED FOR ACTION:

- **Prepare for the due diligence requirements:** understand the metrics, thresholds and DNSH-criteria relevant for the own company's business and investment activities which are subject to due diligence/verification activities and start preparing corresponding internal processes for delivery of new data and information.

22. Taxonomy Regulation, Article 6(b), includes energy efficiency as "substantial contributing to climate change mitigation.

23. Technical Expert Group on Sustainable Finance. Taxonomy Report: Technical Annex. Up-dated Methodology Up-dated Technical Screening Criteria. March 2020, p. 367ff ("Technical Annex").

24. Compliance with the EPBD: Energy Performance of Buildings Directive

25. Reduction of primary energy demand: Technical Expert Group on Sustainable Finance. Taxonomy Report: Technical Annex. Up-dated Methodology Up-dated Technical Screening Criteria. March 2020, p. 380.

26. Remark PED: Technical Expert Group on Sustainable Finance. Taxonomy Report: Technical Annex. Up-dated Methodology Up-dated Technical Screening Criteria. March 2020, p. 380 (footnote no. 429).

27. Level of ambition for Objective 3: www.euwaterlabel.eu.

Table 2. Elements of the DNSH assessment.

DNSH Assessment	Objective 2: Climate Change Adaptation What is required	Implications for corporate energy efficiency investors
Main objective	Reduction of climate related physical risks which might occur in the context of the economic activity in question. Given that the nature and scope of such risks depend on the (regional) circumstances, it has to be defined on a case by case basis.	
Level of ambition	Climate risk assessment, risk mitigation measure to be implemented within 5 years. The level of ambition is set on a "best efforts basis".	Increased complexity of the investment/planning process. Additional cost. Best efforts basis leaves room for flexibility.

DNSH Assessment	Objective 3: Sustainable use and protection of water and marine resources What is required	Implications for corporate energy efficiency investors
Level of ambition	New water appliances must be in the top 2 classes for water consumption of the EU Water Label.	Voluntary EU Water Label currently applied by approx. 60 % of manufacturers. Potential barrier in the first period of application of the taxonomy. Likely increase of the investment cost.

DNSH Assessment	Objective 4: Transition to a circular economy, waste prevention and recycling What is required	Implications for corporate energy efficiency investors
Level of ambition	At least 80 % (by weight) of the non-hazardous construction and demolition waste generated on the construction site must be prepared for re-use or sent for recycling or other material recovery, including backfilling operations that use waste.	Larger construction sites: separating construction waste according to type of material is market practice. Difficult for smaller projects; Increase of complexity and cost.

DNSH Assessment	Objective 5: Pollution prevention and control What is required	Implications for corporate energy efficiency investors
Level of ambition	Components and materials must not contain asbestos and substances of concern included in the "Authorisation List of the Reach Regulation" (1970/2006, 18.12.2006). Prior to renovation, a building survey must be carried out in accordance with national legislation by a competent specialist with training in asbestos.	Increase of complexity to the investment process triggering additional costs. Availability of qualified experts in the different European regions might be challenging.
Level of ambition	In addition, non-road mobile machinery used on construction site must comply with the Regulation on pollutant emissions (EU 2016/1628). This regulation defines strict emission limits for different power ranges and applications.	The requirement to use only low emitting machinery on site will most probably complicate the organisation of the investment measure, narrow the choice of construction companies to be involved and lead to increased cost.

DNSH Assessment	Objective 6: Protection of healthy ecosystems What is required	Implications for corporate energy efficiency investors
Level of ambition	At least 80 % of the timber products used in the renovation for structures, cladding and finishes must stem from either recycled or sourced from sustainably managed forests sources, The latter certified by third party certification audits performed by accredited certification bodies, e.g. FSC/PEFC standards or equivalent.	Compliance is particularly difficult. Global trade flows of timber complicates security as to the type of forest where the timber was produced. Providing the required certification triggers additional cost for sourcing the material and obtain the required certificate.

- **Prepare for communication with the finance provider and/or auditor:** in case finance has been provided by a financial product labelled as sustainable, the company has to be prepared to apply and document the corresponding metrics and thresholds plus prove compliance with the DNSH-criteria.
- Companies obliged to report under the **Non-Financial Reporting Directive** have to prepare reporting in line with “**comply or explain**” approach.

A broad range of parties are potentially involved in the due diligence processes to comply with the transparency requirements of the EU Taxonomy: corporates of all size – small medium and large –, financial institutions, fund managers, investors, insurance companies, industry and services.

Preparing the corporate sector in Germany – new KfW promotional product offer

In order to prepare the German corporate sector for the new challenges and requirements resulting from the EU Taxonomy, KfW has developed a promotional product, which was already introduced in March 2020.²⁸

It is based on the technical screening criteria relevant for KfW small and medium sized private and public corporate clientele as well as professionals and provides low interest finance for investments up to EUR 25 million per investment that meet the technical screening criteria.²⁹

The loans have a tenor of up to 20 years. With this program, first of its kind in Europe, German corporates have the opportunity to start getting prepared for new and ambitious investments to contribute to the transition to a climate neutral economy in 2050.

Summary, conclusion and outlook

- With the EU taxonomy, a European standard is developed to determine the degree of ecological sustainability of economic activities which is first of its nature.
- It provides a clear, scientific based orientation for what is required to achieve the Paris goals and will have long term and cross-cutting impact on the European financial ecosystem.
- With its application, a high degree of standardisation and transparency will be created and investors in investment products labelled as sustainable will benefit from increased transparency, comparability and potential reduction of “greenwashing” of financial products.
- The level of ambition and complexity, however, will cause challenges and trigger additional costs for the parties involved in conducting the necessary due diligence, in assuring and proving compliance with the dense network of requirements.

- On the positive side, corporate investors benefit from a clear orientation on what is required to prove the sustainable character of an investment/business activity and how to qualify for finance from sustainable financing sources.
- The overall market feedback in this regard so far has been positive. It ranges, however, from welcoming the taxonomy but claiming it is not yet ambitious enough to criticism as regards the high level of bureaucracy created underlining the difficult and costly usability and applicability.
- The almost unanimous feedback and concern expressed by market participants in light of the proposed technical screening criteria of the taxonomy is the limited availability of data.
- For corporate investors into energy efficiency, compliance requirements after entering into full force and effect will depend on the specific source of finance. In addition, transparency requirements might be applicable depending on the size of the investor company (non-financial reporting) or the financial institution financing the energy efficiency investment.
- The application of the technical criteria tends to complicate the energy efficiency investment process and creates an increased administrative and cost burden for companies. However, it might have an impact on the future access to finance and therefore this effort is worth it.
- Whatever the details of the final version of the taxonomy criteria are, corporates will have to comply with additional due diligence and reporting requirements of their financiers and/or auditors to satisfy the increased need for information of finance providers and should start assessing the relevance and prepare themselves for this challenge.
- Promotional banks such as KfW can substantially support corporates in this process by offering fit for purpose promotional products.

References

EU Taxonomy Regulation

Position of the Council at first reading with a view to the adoption of a Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

Regulation 2018/0178/COD of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment, and amending Regulation 2019/2088 on sustainability-related disclosures in the financial services sector. <https://data.consilium.europa.eu/doc/document/ST-5639-2020-INIT/en/pdf>

Technical Screening Criteria

EU Technical Expert Group on Sustainable Finance: “Taxonomy report: Technical Annex. Updated Methodology & Updated Technical Screening Criteria”. March 2020. https://ec.europa.eu/info/sites/info/files/business_economy_euro/

28. www.kfw.de. Klimaschutzoffensive für den Mittelstand (Climate protection offensive for medium sized enterprises”).

29. Not included: building sector, DNSH-criteria.

banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy-annexes_en.pdf

EU Technical Expert Group on Sustainable Finance: “Technical Report. Taxonomy: Final report of the *Technical* Expert Group on Sustainable Finance”. March 2020. https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf

Disclosure Regulation

Regulation EU 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

Non-Financial Disclosure Directive

Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, Official Journal. 15.11.2014. https://ec.europa.eu/info/business_economy_euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en

European Green Deal

Communication from the Commission to the European Parliament, the European Council, the European Economic and Social Committee and the Committee of the Regions. The European Green Deal (COM (2019) 640 final). 11.12.2019. 2. https://ec.europa.eu/info/sites/info/files/european-green-deal-communication_en.pdf

EU Action Plan

Communication from the Commission to the European Parliament, the European Council, the European Economic and Social Committee and the Committee of the Regions. Action Plan: Financing Sustainable Growth COM(2018) 97 final. 8.3.2018. https://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth_en

Selected Market Reactions

Reitzenstein, Alexander (E3G), Ostrower, Milena (Germanwatch). Sustainable Finance: Entwicklungen und aktuelle Debatte, March 2020. <https://www.germanwatch.org/de/18298>

International Capital Market Association, Memorandum on EU Sustainability Disclosure Regime. 30.4.2020.

Kliem, Dr. Bernd. PWC Accounting Aktuell. EU-Taxonomieverordnung: Wesentliche neue Angabe-Pflichten für die nichtfinanzielle Berichterstattung werden auf den Weg gebracht. 20.4.2020.

KPMG AG Sustainable Finance Newsletter. Die EU Taxonomie. Februar 2020.

KPMG AG. Regulierung zur Nachhaltigkeit nimmt Fahrt auf. Finales Merkblatt der BaFin und vorläufige EU-Einigung zur EU Taxonomie – eine schöne Bescherung? Januar 2020.

Green Bond Standard

EU Technical Expert Group on Sustainable Finance. TEG Report. Proposal for an EU Green Bond Standard. June 2019. https://ec.europa.eu/info/publications/sustainable-finance-teg-green-bond-standard_en

EU Technical Expert Group on Sustainable Finance. Usability Guide Green Bond Standard. March 2020. https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-green-bond-standard-usability-guide_en.pdf

EPBD

Directive (EU) 2018/844 of the European Parliament and of the Council of 30 May 2018 amending Directive 2010/31/EU on the energy performance of buildings and Directive 2012/27/EU on energy efficiency. Official Journal 19.6.2018. https://ec.europa.eu/info/news/new-energy-performance-buildings-directive-comes-force-9-july-2018-2018-jun-19_en